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Securities Industry
Trends
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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

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A TALE OF TWO INDUSTRIES

It was the best of times. It was the worst of times. The securities industry had its best year ever in 1986 if performance is measured by many of the new record highs which were set. Commissions, trading gains, underwriting, mutual funds, total revenues and profits were but some of the parameters hitting new annual records. The year was also the worst of times when a relatively small number of individuals, with severe deficiencies in distinguishing right from wrong, scared the "Dickens" out of Wall Street, badly tarnishing the industry's image when they violated the public trust. Though not the worst of times, 1986's results, despite the records, also flagged warnings in areas such as mounting cost bases and deteriorating margins.

HIGHLIGHTS

1. In 1986, the securities industry earned a record pre-tax profit of $5.5 billion, up 33.1% over 1985's then record $4.1 billion.

2. Industry revenues last year jumped 29.7% to a record $50.1 billion. Expenses, however, rose almost as much, 29.3%, to $44.6 billion, also a record level.

3. Last year's 11.0% pre-tax profit margin, while slightly better than 1985's 10.7%, was mediocre for the Eighties - three years were better, three were worse.

4. Pre-tax ROE of 28.6% last year was the second lowest of the Eighties - only the 13.3% registered in 1984 was worse.

5. In this issue of Trends, SIA has for the first time attempted to estimate the components of "other revenue related to the securities business." Last year, the estimates showed 21% derived from private placement fees and 23% from M&A. We welcome comments from our readers regarding these estimates and the methodology used.

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Table 1

STATEMENT OF INCOME
TOTAL SECURITIES INDUSTRY

(In $ Millions)

Revenues	1985	1986	% Change
Commissions	8,238.4	10,472.6	27.1
Trading Profits	9,944.3	12,560.8	26.3
Investment Gains	1,089.2	1,143.3	5.0
Underwriting	4,250.3	5,938.6	39.7
Margin Interest	2,577.7	2,919.5	13.3
Mutual Fund Sales	1,642.8	2,801.1	70.5
Fees, Account Supervision	947.4	1,466.7	54.8
Research	17.8	45.6	156.2
Commodities	983.2	1,064.7	8.3
Other Securities Related	7,176.4	9,552.0	33.1
Other Unrelated	1,757.7	2,119.0	20.6
Total Revenues	38,621.2	50,082.4	29.7
Expenses			
RR Compensation	6,903.6	9,183.8	33.0
Clerical Compensation	5,218.5	8,423.2	35.5
Partner/Officer Comp.	1,119.9	1,358.0	21.3
Other Employee Comp.	331.3	439.7	32.7
Floor (Commission/Clearing)	1,310.3	1,697.8	29.6
Communications	1,921.8	2,288.1	19.1
Occupancy & Equipment	1,830.7	2,178.5	19.0
Promotional Costs	841.5	1,036.4	23.2
Interest Expense	10,127.6	12,425.4	22.7
Errors/Bad Debts	266.3	431.9	62.2
EDP	477.8	632.2	32.3
Non-Recurring Charges	98.9	70.7	(28.5)
Regulatory Fees	244.8	310.1	26.7
Other	2,797.4	4,096.2	46.4
Total Expenses	34,481.2	44,570.9	29.3
Pre-Tax Net Income	4,140.0	5,511.5	33.1

JUST FOR THE RECORD

Last year, we reported that the securities industry's profits and all major revenue lines rose substantially to record heights from the previous year. But that was relatively easy when comparing bull year 1985 to bear year 1984. This go-round it is a pleasure to report that 1986 repeated its predecessor year's climb in performance, which is all the more impressive since we're comparing a record year to another record year!

Table 1 graphically highlights the 30% gains in revenues and 33% gains in profits which catapulted these industry performance yardsticks to new records of $50.1 billion and $5.5 billion, respectively. As depicted, all revenue lines were up anywhere from 5% to 156%...all to record levels. Conversely, if we ignore non-recurring charges (a legitimate dismissal due to their nature), all expense categories were likewise, though unfortunately, rising also to new record totals.

Still, revenue gains outpaced rising costs which translated into a 33% gain in pre-tax profits to a record $5.5 billion!

Before analyzing the details of last year's income statement, a quick look at these three main items (revenues, expenses, profits) during the Eighties gives some interesting background. Table 2 shows how both revenues and expenses have consistently increased from $16 billion and $14 billion, respectively, in 1980 to $50 and $45 billion last year. It also shows that in two of these seven years, 1981 and 1984, expense growth outpaced revenue gains resulting in declines in profitability. Finally, it shows that 1986, despite the record aggregate amounts achieved, was mediocre for the industry compared to the Eighties, with three years better and three years worse in profit margins, revenue growth, expense growth and profit growth. Obviously, as the securities industry keeps growing from what was essentially a cottage industry to a $50 billion industry today, it becomes harder and harder to match the growth patterns of past bull market years.

Table 2

TOTAL INDUSTRY ANNUAL PERFORMANCE

$ Billions	80	81	82	83	84	85	86
Revenues	16.0	19.8	23.2	29.6	31.2	38.6	50.1
Expenses	13.8	17.7	20.2	25.7	29.6	34.5	44.6
Profits	2.3	2.1	3.0	3.8	1.6	4.1	5.5
% Change							
Revenues	42.7	23.5	17.2	27.4	5.6	23.7	29.7
Expenses	35.9	28.2	14.3	27.6	15.0	16.5	29.3
Profits	105.7	(5.2)	41.5	26.0	(57.9)	157.5	33.1
Profit Margin (%)	14.1	10.8	13.1	12.9	5.2	10.7	11.0

Note: Annual percent changes and profit margins calculated on actual figures in millions of dollars.

MUTUAL FUNDS

Though growth becomes harder to achieve, some areas have turned in remarkable performances. Revenues from the sale of open-ended investment company shares last year were up 71%, by far the best year-to-year climb for any major revenue source (research jumped 156%, but at $46 million is still less than 0.01% of all revenues...see table 1).

Closing at $2.8 billion for 1986, mutual fund revenues have increased 27-fold from the $105 million logged in 1980. Still, despite the phenomenal explosion in mutual funds' popularity, as this field also matures the growth and profitability trends also become harder and harder to maintain.

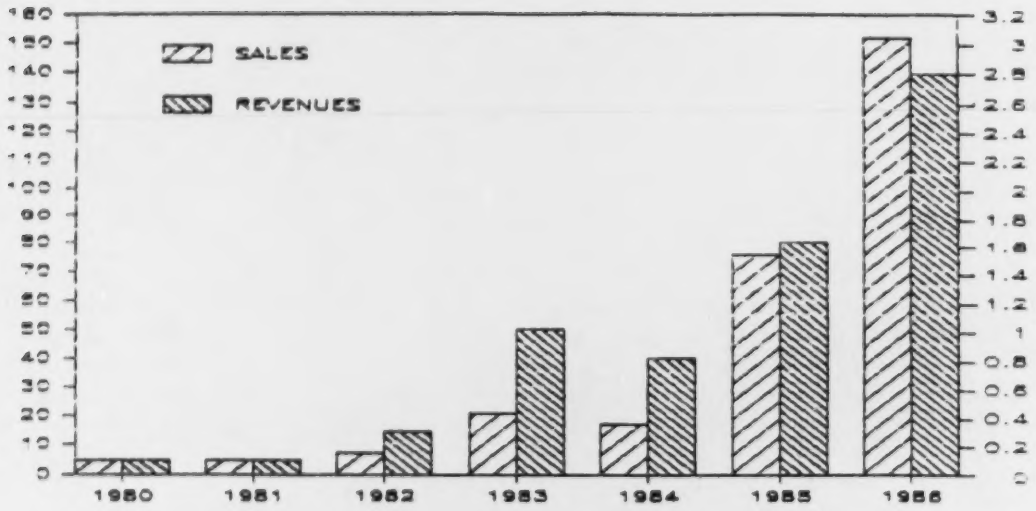
Table 3 maps the revenues from open-end mutual fund sales to the aggregate amount of new sales of equity and balance oriented mutual funds as compiled by the Investment Company Institute (ICI). As is shown in the table and graphically depicted in the chart beneath, the amount of revenues in relationship to the amount of sales kept increasing (margins kept getting better) through 1984 and then began declining (though totals kept increasing). Roughly speaking (using the ICI's sales figures vs industry revenues), the industry went from $43 dollars worth of mutual fund sales in 1980 to just $22 in 1983 and 1984 to produce $1 in revenues. Subsequently, the dollar amount of mutual fund sales needed to keep generating that $1 in revenues has shot up to $46 in 1985 to $54 last year. As the product life cycle matures, the inevitable margin erosion occurs...volume has skyrocketed and the resultant fierce competition has driven down the margin on revenues.

Table 3

MUTUAL FUNDS

Sales ($ Bils)

Revenues ($ Bils)



	New Sales* ($ Bils)	Revenues ($ Mils)	Sales/Revenues (Ratio)
1980	$4.5	$104.7	43 X
1891	4.6	122.0	38
1982	6.8	287.5	24
1983	20.8	952.1	22
1984	16.5	750.9	22
1985	76.3	1,642.8	46
1986	152.1	2,801.1	54

* New Sales are for equity and balance oriented mutual funds compiled by the Investment Company Institute

FEE INCOME

Fee income, from account advisory and supervision, increased 55% last year, breaking the billion dollar mark for the first time, to a record $1.5 billion. Since 43% of this amount was produced from the 10 National Full Line firms, the "financial consultant" type approach being emphasized by many of these firms seems to be producing some results.

UNDERWRITING

Underwriting revenues also made a dramatic 40% leap above last year's record level to a new $6 billion record. The mix of corporate/municipal debt financings, however, did a complete flip-flop, with corporates more than doubling to $228 billion underwritten while munis fell from $243 billion underwritten in 1985 to $161 billion, due to tax changes and other restrictions. In fact, it was the first time in the Eighties where corporate debt underwritings outpaced munis, and they did so with a vengeance (see Table 4). Still, even with the corporate onslaught last year, corporate bonds (at least the U.S. domestic portion) have yet to outpace 1985's $243 billion publicly offered municipal bonds (although equities drive the corporate total up to $285 billion).

Table 4

DOMESTIC DEBT UNDERWRITNGS

	Corporate ($ Bils)	Municipal ($ Bils)
1980	$41.3	$48.4
1981	40.5	47.7
1982	43.9	78.3
1983	52.2	85.7
1984	69.4	128.8
1985	104.9	243.3
1986	228.4	161.2

Source: IDD Information Services

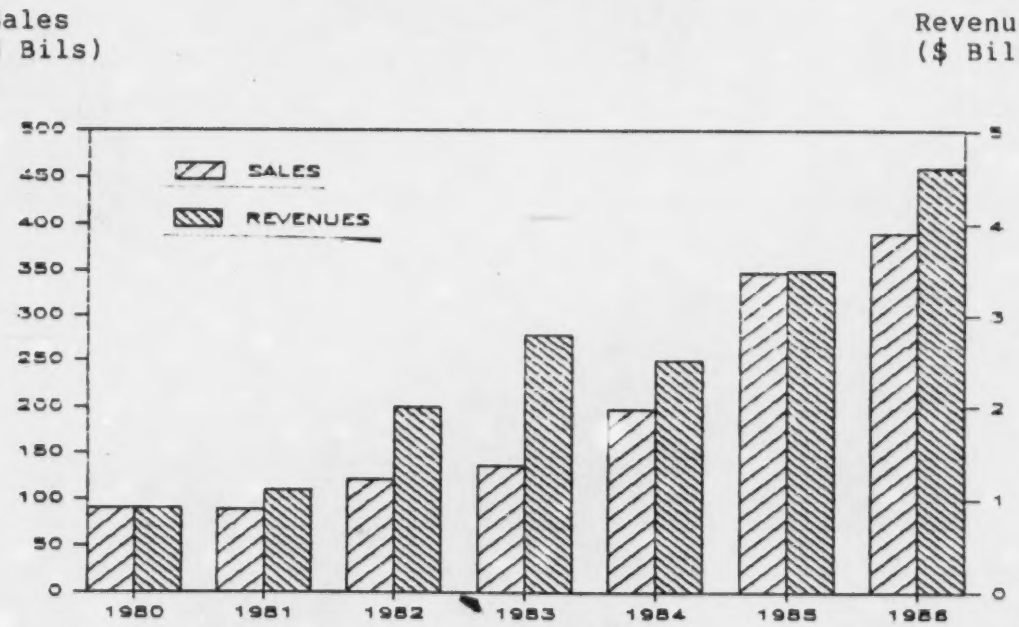
However, since revenues from bond underwritings are not currently available by sub-categories, such as corporates, munis, or any other breakdown, we must look at all domestic bond underwritings vs. all bond underwriting revenues. As Table 5 shows, the amount of bonds underwritten needed to generate $1 in revenues fell from $97 in 1980 to $49 in 1983. However, a thinning of spreads began to occur and this was largely laid at the door of Rule 415's advent, which

accelerated the trend towards stiffer competition, smaller, if non-existant syndicates, one/two-handed accounts, and an explosion in thin margin financings such as CMOs.

The heartening news for corporate and muni syndicate managers is that the trend reversed last year. It fell back to $85 worth of bonds needed to raise $1 in bond underwriting revenues. The second best ever year for munis and the record year for high-yield (and thus high-spread) corporates, no doubt helped. Disheartening is that beyond about a half dozen firms, controlling about two-thirds of all bond underwritings, only a handful of firms capture even 1% of the dollar amount of bonds underwritten.

Table 5

ALL DOMESTIC BOND UNDERWRITINGS



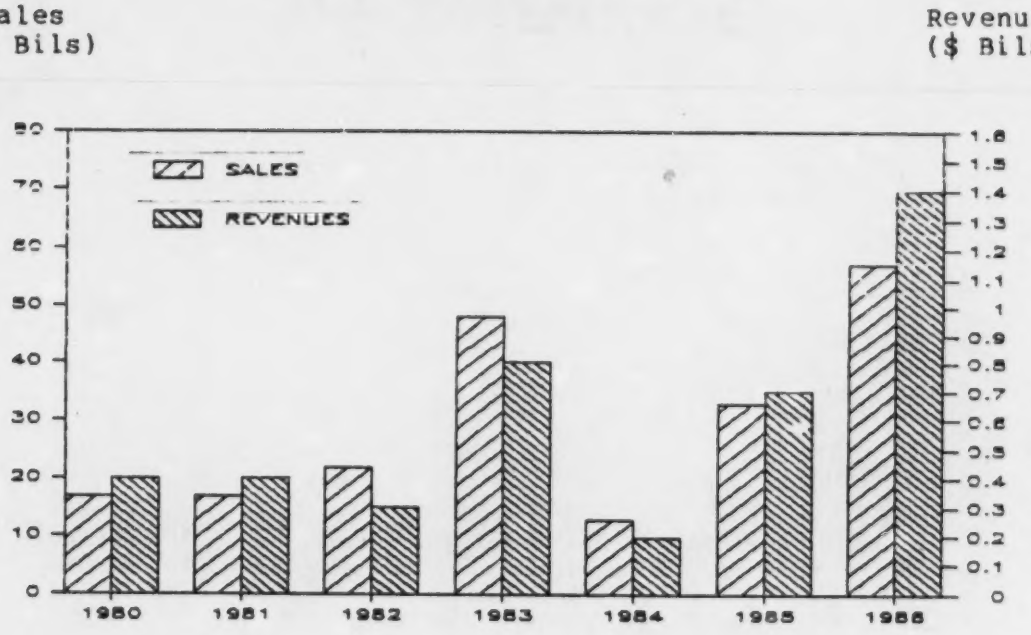
	Amount ($ Bils)	Revenues ($ Mils)	Amount/Revenues (Ratio)
1980	$ 89.7	$ 924.5	97 X
1981	88.2	1,144.0	77
1982	122.2	1,987.9	61
1983	137.9	2,786.9	49
1984	198.2	2,457.8	81
1985	348.2	3,501.9	99
1986	389.6	4,566.3	85

Source: Securities Industry Database, IDD Information Services

For corporate equities, where concentration is slightly less than on the bond front, Table 6 shows how the amount of equities needed to bring in that $1 in revenues has steadily improved since 1983's bull market (although aggregate underwritings and revenues were best in bull years 1983 and 1986 - heavily due to initial public offerings).

Table 6

CORPORATE EQUITY UNDERWRITINGS



	Amount ($ Bils)	Revenues ($ Mils)	Amount/Revenues (Ratio)
1980	$16.6	$403.3	41 X
1981	16.7	424.1	39
1982	21.7	328.2	66
1983	47.8	754.5	63
1984	12.9	248.3	52
1985	33.3	748.4	44
1986	57.0	1,372.3	42

Source: Securities Industry Database, IDD Information Services

COMMISSIONS

Commission revenues climbed 27% to a record $10.5 billion, or 21% of total revenues. This was second only to trading profits, $12.6 billion, or 25% of total revenues. Despite the record amount of dollars raised via commissions, Table 7 shows how 1986 continued the trend towards the overall industry's declining dependence on commissions as yesteryear's primary revenue source.

Table 7

COMMISSIONS' SHARE OF TOTAL REVENUES

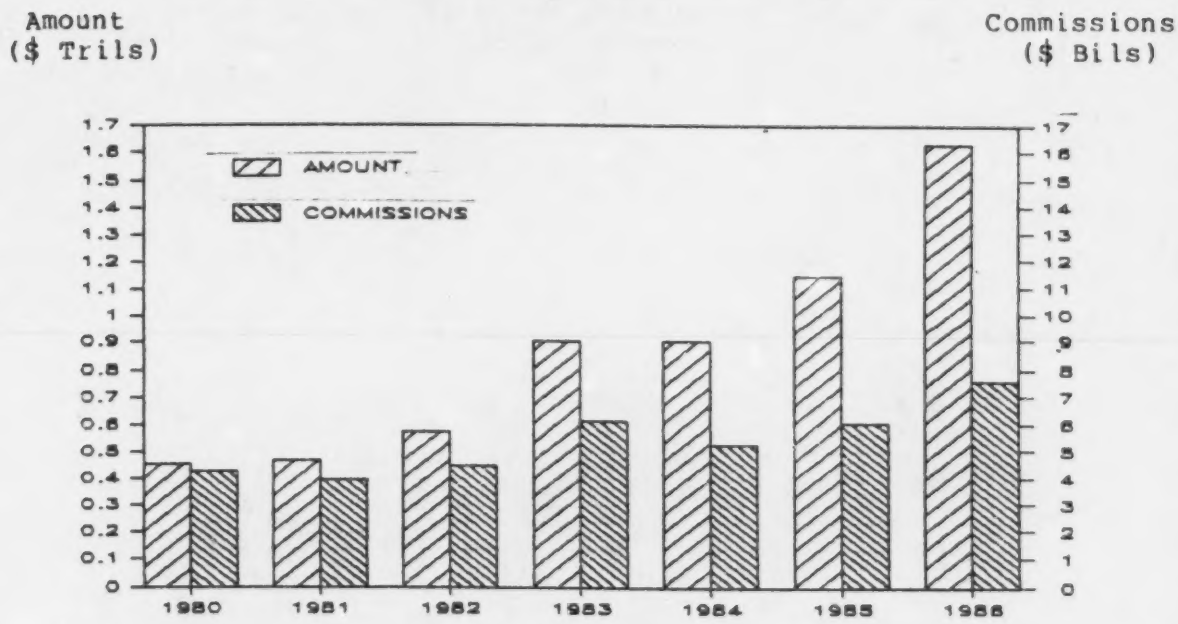
1973	55.4%
1974	49.1
1975	49.9
1976	45.8
1977	41.7
1978	42.8
1979	35.8
1980	35.4
1981	27.0
1982	25.9
1983	28.2
1984	22.7
1985	21.3
1986	20.9

Not only are total commission revenues declining in importance relative to total revenues, but if you compare commission revenues from listed equities executed on an exchange (the bulk of all commissions, 72% of total commissions last year) to the value of those equities crossed, there's been a dramatic erosion in commission dollars relative to the value of those shares.

Table 8 illustrates how much larger amounts of equity business must now be transacted in order to generate the same commission dollar of previous years. Back in 1980, the value of shares traded on the NYSE, AMEX and Regional Exchanges, $453 billion, was 107 times the $4 billion in commission revenues from equities traded on those markets. This steadily eroded and last year it took twice the amount of equity volume as in 1980 to generate the same commission dollar: the $1.6 trillion worth of equities traded was 216 times the $7.6 billion in revenues from listed equities.

Table 8

LISTED EQUITIES - COMMISSIONS VS. AMOUNT TRADED



	Amount ($ Bils)	Commissions ($ Mils)	Amount/Commissions (Ratio)
1980	453.3	4,237.5	107 X
1981	464.2	3,954.7	117
1982	575.3	4,484.1	128
1983	903.8	6,131.5	147
1984	901.2	5,232.6	172
1985	1,147.4	6,069.8	189
1986	1,630.7	7,561.9	216

In other words, while the value of listed equity business has grown 3.6 fold since 1980, commissions from that business grew at half that rate...1.8 fold!

Quite often, this erosion is laid at the doorstep of increased institutional dominance of the equities business. In the past this growth in institutional participation was "proved" using proxies for institutional/retail activity such as block volume. Beginning in early 1985, SIA has been able to track the actual total activity of the retail, institutional and member trading proportion of volume on the NYSE and AMEX (and professional institutional share of activity on NASDAQ). Unfortunately, this does not yet allow for much of a historical comparison, but if "institutionalization" is the culprit in the lag of commission growth relative to total listed equity business, the figures for 1985 vs. 1986 certainly don't support this claim.

Table 9 clearly shows that professional institutions' share of total share activity on the NYSE, AMEX and OTC marts declined from their 1985 levels last year (though aggregate activity was up for all categories). Both the retail and member trading share of last year's activity were up. Therefore, at least for 1985 vs 1986, part of the answer lies in changes in overall, including retail, commission rates, ever increasing RR payout structures applied (for payout effects see Table 15) and industry-wide discounting now being a fact of life.

Table 9

PROPORTION OF SHARE ACTIVITY BY SECTOR

	NYSE Proportion of Share Activity		AMEX Proportion of Share Activity		OTC Proportion of Share Activity	
	1986	1985	1986	1985	1986	1985
Professional Institutions	42.3%	45.3%	25.6%	28.4%	19.3%	21.4%
Retail Sector	29.9	28.9	54.0	51.9	N/A	N/A
Member Firm Trading	27.8	25.8	20.4	19.7	N/A	N/A

* 1985 data only May to December 1985

Source: SIA, Investor Activity Report

TRADING

As previously mentioned, trading gains were again the number one revenue source for the securities industry last year accounting for one quarter of all revenues. Hitting a record $12.6 billion, this now premier revenue generator increased 26% over last year's record $10 billion amount. As was the case with commissions, however, the year-to-year increase slightly lagged overall revenue increases of 30%. That slight lag left 1985 as the record year for trading's largest percentage contributor to total revenues (although only marginally more than in 1986) but trading's growing, if not dominant, importance is illustrated in Table 10.

Table 10

TRADING'S SHARE OF TOTAL REVENUES

1973	8.4
1974	12.8
1975	15.6
1976	17.5
1977	15.7
1978	14.8
1979	19.2
1980	19.6
1981	21.4
1982	25.6
1983	23.1
1984	24.2
1985	25.7
1986	25.1

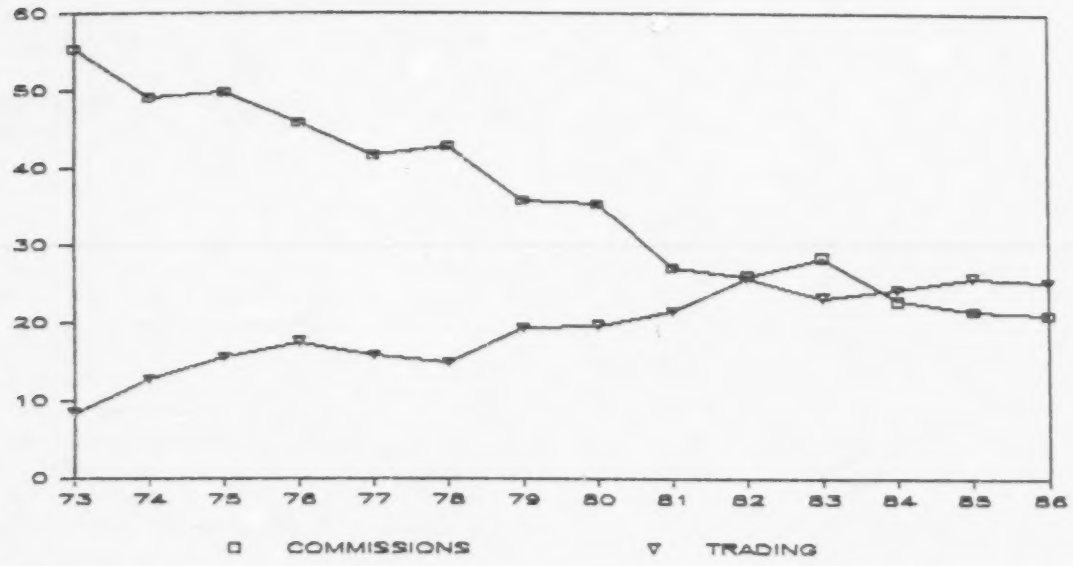
Note: 1973-75 includes trading as well as investment gains.

Tradings' growing importance mirrors commissions' declining share, that is your left appears as your right. Table 11 shows the percent of total revenues each business contributed since 1973 and commissions' once major role converges with tradings' once minor role until the Eighties when they are now diverging in favor of tradings' new dominance.

Table 11

COMMISSIONS VS. TRADING REVENUES

Percent of
Total Revenues



INVESTMENT GAINS

If any area of the securities business last year epitomized "the best of times vs. the worst of times," it was in gains and losses from firms' own investment accounts. For the year, the $1.1 billion net gain from this area was up a mere 5% over 1985, although that was still a record amount. The bad news was that at mid-year, the amount stood at $1.2 billion before turning downhill.

The third quarter's mere $174 million gain was more than wiped out with $201 million in the loss column for the final quarter, resulting in 1986 closing at lower than its mid-year level. Not coincidentally, this was the quarter when some major firms took major hits on their investments subsequent to Ivan Boesky's pre-announcement, and SEC-sanctioned, selloff. At any rate, the quarter-to-quarter volatility last year in investment gains/losses, should be sending up a few warning flags to those firms targeting as a major profit source areas such as taking positions in their own deals, bridge financings, LBOs, mezzanine financings, etc., to the risk side of the risk/reward ratio. As Goldman, Sachs partner James P. Gorter said at SIA's Trends Conference this January: "When

you're putting up billions of dollars in credit or billions of dollars in bridge financing or when you're standing behind transactions of that size, you're taking inordinate risks, and I'm not sure any reward is worth that risk."

OTHER SECURITIES RELATED REVENUE

With the current limitations of the FOCUS Report's income statement format and instructions, differences in line reporting by carrying and non-carrying firms, and resultant variations in interpretation and reporting, analyzing the line "other revenues related to the securities business" is, at best, a difficult chore.

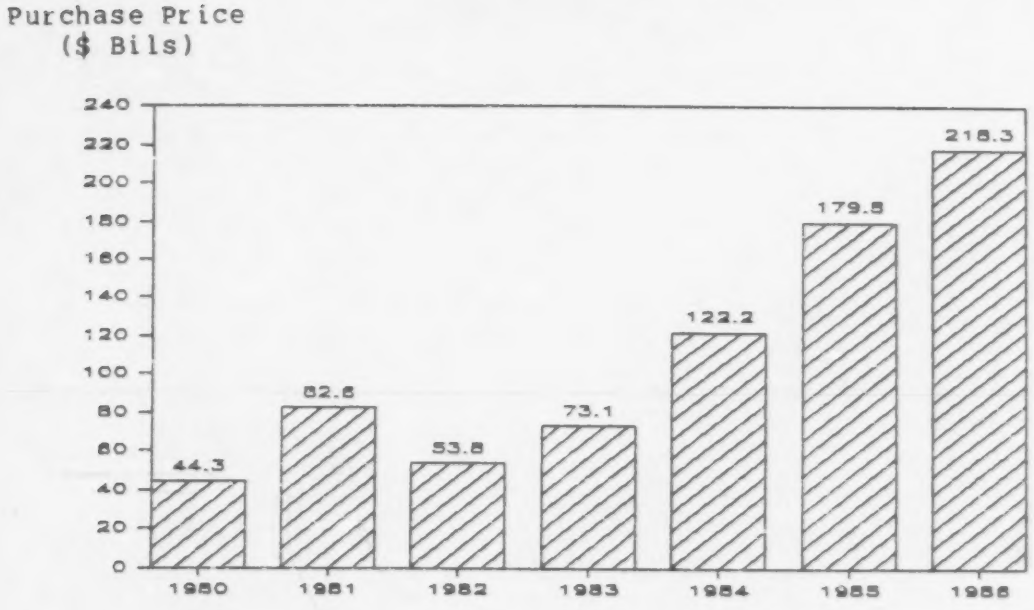
First, non-carrying firms filing FOCUS Part IIA, are instructed to place their M&A and private placement revenues under underwriting revenues. Nevertheless, these firms constitute only about 2% of all revenues. Carrying firms are told to place private placement, proxy solicitation fees, service charges, option fees conducted away from an exchange, etc., in other securities related revenue.

Since this revenue line constitutes about 20% of total revenues and nearly $10 billion last year, it deserves some analysis, although lack of data presents obvious limits. It has been SIA's judgement that the bulk of the revenues reported here are attributable to M&A activity, private placement fees and dealings in repos and reverse repos, although their total or individual share is unknown. But since data is now available on two of these three markets, M&A and private placements, it is of some use to look at these markets when observing "other securities related" and its 33% gain last year to nearly $10 billion.

First, the 10 Large Investment Banks reported $3.9 billion and the 10 National Full Line Firms reported $3.7 billion, or together about 80% of the total. These same firms are found in the top rankings for M&A and private placement financings. However, it must be remembered that these two fields are open to non-securities firms and some large commercial banks also appear side by side with securities firms in the top rankings. So, fees from these two investment banking functions are not totally funneled into the securities industry.

Table 12

MERGERS & ACQUISITIONS



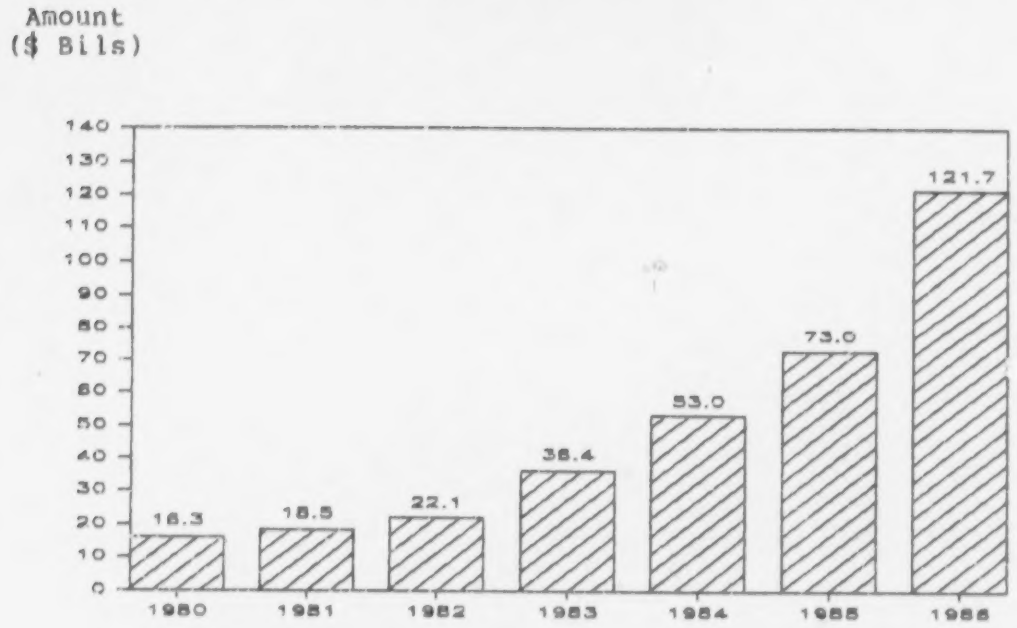
Sources: 1980-85 data, W.T. Grimm & Co. for publicly announced deals of $500,000 or more (purchase 10% or greater interest). 1986 data, IDD Information Services, for publicly announced deals of $1 million or more (including repurchases, self-tenders and recapitalizations of 50% or more).

Since 1980, the dollar value of M&A activity has increased five-fold from $44 billion to $218 billion (Table 12). Not surprisingly, all but one of the top 10 advisors for both acquiror and target companies last year were National Full Line Firms and Large Investment Banks, according to rankings provided by IDD Information Services (the other being a non-NYSE firm, Kohlberg Kravis Roberts).

Using IDD's figures for deals of $1 billion or more where fees were announced, we come up with a weighted average of 1.01% as the total fees vs. the purchase price paid by both the acquiror and target companies. Using that weighted average vs. the $218.3 billion in M&A purchase prices paid last year gives an estimate of $2.2 billion in M&A fees last year. Assuming the bulk of that was paid to NYSE member firms, we estimate about 23% of the $9.6 billion "other related" revenues last year came from M&A fees.

Table 13

PRIVATE PLACEMENTS



Source: Investment Dealers' Digest/IDD Information Services

While M&A has experienced a five-fold increase from 1980 through 1986, domestic private placements nearly doubled that growth with a nine-fold increase going from $16 billion to $122 billion (Table 13). In this area, commercial banks have a much bigger foothold. According to IDD's rankings, last year six of the top 20 agents (based on equal credit to each agent) were commercial banks with a combined market share of 18.6% of the $122 billion placed. Since these top 20 have a combined 98% market share, these 20 are effectively the industry and thus the securities industry handled roughly 80% of all private placements last year.

Unfortunately, due to their nature, data on fees from private placements are difficult to ascertain. Using last year's average gross spread on publicly offered corporate bonds of 2.04% against all private placed debt and equity-related issues gives a reasonable estimate of the fees generated in this arena. This gives a total of $2.5 billion in private placement fees, $2 billion (80%) of which would have flowed to the securities industry. That translates into another 21% of "other securities related" revenues for a total of 44% of this revenue line contributed from both M&A and private placements (Table 14).

Table 14

SOURCES OF "OTHER SECURITIES RELATED" REVENUE

INTEREST

Margin interest increased only 13% from 1985 to 1986, about half the rate of increase in commissions, 27%, and interest expenses, 23% (see Table 1). During the year, margin interest revenues were pretty steady with quarterly results of $703, $745, $722 and $750 billion, respectively, reported during each of the quarters (see Table XX). Though rates charged on margin accounts steadily declined about 200 basis during the year, it would not be unfair to have expected better overall margin interest results considering margin debt balances (for our NYSE member group) during the year showed a 37% linear increase from January's $27 billion outstanding to December's $37 billion, a much higher relative increase compared to the interest rate decline.

In comparison, the previous year, 1985, when there was only a 100 basis point dropoff in rates, margin interest revenues steadily increased from $585 million in Q1 to $709 million in Q4, while margin debt balances increased steadily from $22 billion in January to $28 billion in December.

Here, again, FOCUS reports are limited in the analysis which can be applied to interest income, expense and profits. Although margin interest is broken out on the revenue side of the income statement, total interest revenue is not (e.g. interest and dividends are netted against trading revenues). On the other hand, on the expense side of the income statement, total interest expense is reported.

To arrive at some estimate as to how the industry fares on a net interest income level, we examined the financial reporting of the publicly held brokerage firms. For both the major publicly held National Full Line and large Investment Bank brokerages, as well as all the publicly held brokerages, 1986 showed a median 5% net interest income to net revenues. Projecting this to our industry figures shows total gross interest income of approximately $14.3 billion last year, or 27% of total revenues. Since the industry showed total interest expense of $12.4 billion last year, that leaves $1.9 billion as net interest income for 1986.

EXPENSES

Compensation, the industry's ever present largest expense, 44% of all expenses last year, up from 42% in 1985, continues to be the single most important cost which haunts the securities industry's profit margins. Also, the biggest siphon of dollars in the compensation area, is RR compensation. Last year, RR comp. increased 33% over 1985's $6.9 billion to a record $9.2 billion. That outpaced both commissions' 27% year-to-year increase and overall revenues' 30% gain!

Table 15 illustrates how there is an overall "inelasticity of demand" in the industry's payout structure on both the retail and istitutional sales levels.

Table 15

MEDIAN RR PRODUCTION AND PAYOUT

($ Thousands)

Production

	1981	1982	1983	1984	1985
Retail	106	114	139	121	136
Institutional	307	422	570	370	424

Payout

	1981	1982	1983	1984	1985
Retail	41	41	42	43	43
Institutional	32	28	29	29	31

Source: Report on Production and Earnings of RRs in 1985, SIA

Despite dropoffs in median gross production of both institutional and retail RRs in 1985 and 1984 from their 1983 levels (1986 data not yet available), payout ratios were still increased. Naturally, the competition for productive RRs is extremely intense since they are the backbone of industry profitability. This makes it extremely difficult for firms to alter downward their payouts because of the very justified fear that this will cause both an exodus of their best producers and a strong deterrent in attracting new talent.

Nevertheless, this predominant of all competitive pressures remains the number one margin destroyer of the securities industry and always wreaks havoc on the income statement whenever the bear stirs from hibernation. Whenever any firm does attempt to rejigger its payout structures in its own favor, it usually does suffer the exodus/competitive disadvantage consequences. Will there ever occur an industrywide concerted effort to radically alter the payout structure? Though it's often called for, collusion would be illegal and competitive pressures have proven that to unilaterally attempt the change can be suicidal. Nevertheless, some progress was made at some firms last year in realigning payouts on some product lines, e.g. high margin, in-house mutual funds, etc., and on lower producing earners.

Back-office personnel costs last year actually showed a bigger increase than RR comp. Up 36% from 1985 to a record $8.4 billion, this cost is equally eating away at revenue income...22% of all 1986 revenues.

INTEREST EXPENSE

If compensation is looked at by its different components and not just one large cost item, then interest expense is the biggest ticket on the expense sheet. Last year's $12.4 billion interest expense was 28% of all expenses. Still, as shown earlier, net interest was estimated to be in the plus column at $1.9 billion for 1986.

Overall, interest expense increased 23% for 1986 vs. 1985. That was a lot slower increase than the 30% gain in revenues. Quarterly, interest costs hovered at around $3 billion (see Table 20). Though interest rates dropped around 200 basis points over these four quarters, the steady interest cost over the period was not bad considering liabilities rose $5 billion during the same period.

OTHER EXPENSES

Error and bad debt expenses jumped 62% to $432 million last year or 0.9% of total revenues. For the previous five years, errors accounted for a slightly lower 0.7% to 0.8% of revenues. Although these amounts look relatively small when compared to other expenses ranging in the billions, industry worries over the burdens of handling ever record breaking amounts of orders do appear to be taking more of a toll on the error cost column.

Communications, occupancy, equipment, promotional and regulatory fee expenses all increased at much slower rates than revenue's 30% gains in 1986. Non-recurring charges even showed a 29% drop from 1985's level. If there had been bigger increases in almost any of these items, overall expenses could have outstripped revenue's 30% gain.

QUARTERLY PERFORMANCE

Table 17 shows last year's first quarter revenues hit a record $12.91 billion and then fell off until the last quarter which broke that record with $12.96 billion in revenues. Profits followed a similar pattern, but with one major exception. In the first quarter, pre-tax profits hit a quarterly record $1.95 billion. As with revenues, profits declined for the next two periods and bounced back in the last quarter.

The major exception was that profits didn't bounce back to a new quarterly record as did revenues. Expenses, again, keep increasing faster than revenues. As Table 16 shows, pre-tax profit margins last year fell from a high of 15.1% in the first quarter to 9.0% in the last quarter. For the past two years, only 1985's third quarter margin of 8.0% was lower than the margin in Q4 1986.

Table 16

TOTAL INDUSTRY QUARTERLY PERFORMANCE

$ Billions	85.1	85.2	85.3	85.4	86.1	86.2	86.3	86.4
Revenues	8.9	9.2	8.8	11.6	12.9	12.5	11.8	13.0
Expenses	8.0	8.2	8.1	10.1	11.0	11.1	10.7	11.8
Profits	0.9	1.0	0.7	1.5	1.9	1.3	1.1	1.2
% Change								
Revenues	5.2	3.2	(4.3)	31.2	11.3	(3.4)	(5.7)	10.3
Expenses	0.1	2.4	(0.9)	24.5	8.3	1.6	(4.0)	10.4
Profits	86.4	9.7	(31.0)	108.4	32.2	(31.8)	(20.0)	9.5
Profit Mgn (%)	10.4	11.1	8.0	12.7	15.1	10.7	9.1	9.0

Note: Quarterly percent changes and profit margins calculated on actual figures in millions of dollars.

Table 17

STATEMENT OF INCOME
TOTAL SECURITIES INDUSTRY

(In $ Millions)

Revenues	86:Q1	86:Q2	86:Q3	86:Q4
Commissions	2,765.8	2,702.2	2,527.0	2,477.6
Trading Profits	3,962.1	2,808.6	2,815.3	2,974.8
Investment Gains	597.0	572.9	174.0	(200.6)
Underwriting	1,147.0	1,532.3	1,456.8	1,802.5
Margin Interest	702.8	745.4	721.7	749.6
Mutual Fund Sales	636.0	706.6	707.3	751.2
Fees	272.6	343.7	344.4	506.0
Research	4.8	10.1	22.2	8.5
Commodities	167.4	252.6	261.1	383.6
Other Related	2,150.7	2,263.5	2,242.6	2,895.2
Other Unrelated	501.6	525.0	479.3	611.1
Total Revenues	12,908.0	12,462.7	11,751.6	12,960.1
Expenses				
RR Compensation	2,235.4	2,271.3	2,213.4	2,463.7
Clerical Compensation	2,074.2	2,091.6	2,099.7	2,157.7
Partner/Officer Comp.	356.0	339.9	288.9	373.3
Other Employee Comp.	99.2	129.6	108.8	102.1
Floor Expenses	413.6	425.7	422.8	435.7
Communications	534.9	573.3	561.3	618.6
Occupancy & Equipment	510.3	517.5	550.3	600.4
Promotional Costs	219.8	252.5	241.9	322.2
Interest Expense	3,143.9	3,195.9	2,959.1	3,126.5
Errors/Bad Debts	110.4	80.3	93.1	148.1
EDP	148.1	162.4	156.1	165.6
Non-Recurring Charges	5.4	44.2	5.1	16.0
Regulatory Fees	69.4	73.1	77.0	90.6
Other	1,038.4	975.0	909.3	1,173.3
Total Expenses	10,958.3	11,132.1	10,686.7	11,793.8
Pre-Tax Net Income	1,949.7	1,330.6	1,064.9	1,166.3

Table 18

TOTAL INDUSTRY ANNUAL FINANCIAL CONDITION

$ Billions	80	81	82	83	84	85	86
Assets	102.3	121.6	172.4	215.2	276.0	393.8	451.8
Liabilities	96.9	114.9	163.5	203.4	263.2	377.2	430.4
Capital	6.7	8.1	10.7	14.2	16.7	21.9	29.8
Equity	5.4	6.7	9.0	11.8	12.8	16.7	21.4
% Change							
Assets	36.3	18.9	41.8	24.8	28.3	42.7	14.7
Liabilities	36.5	18.6	42.2	24.4	29.4	43.3	14.1
Capital	34.5	19.9	32.9	32.4	18.1	31.0	36.0
Equity	33.9	24.7	34.3	31.5	8.6	29.9	28.6
Pre-Tax ROE (%)	49.2	35.9	40.5	36.6	13.3	29.4	28.6
After-Tax ROE (%)	26.6	19.4	21.9	19.8	7.2	15.9	15.5

Note: Annual percent changes and ROEs calculated on actual figures in millions of dollars. After-tax ROEs assume a 46% corporate tax rate.

BALANCE SHEET ANALYSIS

As table 18 clearly shows, the industry's return on equity last year was the second lowest of the Eighties despite the record profits earned and three years in the Eighties with lower profit margins than 1986. Only in the poor 1984 was the industry's ROE at a lower level. If you look at the leveraging that has occurred in the Eighties, four out of the seven years, assets and liabilities were expanding at bigger rates than the industry's equity. Last year, the industry's equity base expanded 29% - double the 14% and 15% rate liabilities and assets grew. Even in years 1981 and 1983, when equity grew faster than assets and liabilities, it didn't come close to growing twice as fast as it did last year.

For many who have expressed very real concern that the securities industry is too highly leveraged, last year's bit of unleveraging will be of some comfort. However, this near $5 billion of new equity, with a year-end close of over $21 billion, was not utilized to the productive levels of previous years (as the previously discussed higher ROEs in the rest of the Eighties indicates) nor was it bringing in a return comparable to other measures of returns last year. As Table 19 clearly shows, even before taxes, the industry's 28.6% ROE underperformed areas such as the Dow, the S&P 500 or even the return on rare coins!

Table 19

1986 PERFORMANCE SCOREBOARD

(Annual Return in Percent)

Industry Pre-tax ROE	28.6
Dow Jones Industrial Average	33.6
S&P 500	31.6
Lipper Growth Fund Index	30.3
Lipper International Fund Index	48.2
Rare Coins	32.0

Source: Wall Street Journal, January 2, 1987.

If the year's ROE was poor, it is even more so when you consider how much the first quarter helped from dropping off the board. For the second half of 1986, the industry was earning only 11% to 12% after taxes on its growing equity base.

Comparing last year to the beginning of the Eighties, the industry has increased its equity and capital base four-fold since 1980, but it only managed to increase its revenues three-fold and its profits two-and-one-half-fold.

Table 20

TOTAL INDUSTRY QUARTERLY FINANCIAL CONDITION

$ Billions	85.1	85.2	85.3	85.4	86.1	86.2	86.3	86.4
Assets	254.7	282.4	298.7	393.8	400.0	417.0	431.1	451.8
Liabilities	241.7	268.6	284.4	377.2	381.7	397.6	410.6	430.4
Capital	16.8	17.8	18.7	21.9	24.7	26.0	28.0	29.8
Equity	12.9	13.7	14.3	16.7	18.3	19.4	20.5	21.4
% Change								
Assets	7.7	10.9	5.8	31.9	1.6	4.2	3.4	4.8
Liabilities	8.1	11.1	5.9	32.6	1.2	4.2	3.3	4.8
Capital	(0.5)	6.4	5.1	17.0	12.5	5.5	7.7	6.3
Equity	1.5	6.0	4.3	16.4	10.0	5.8	5.7	4.6
Pre-Tax ROE (%)	29.0	30.8	20.2	38.1	44.6	28.2	21.4	22.3
After-Tax ROE (%)	15.7	16.6	10.9	20.6	24.1	15.3	11.5	12.0

Note: Quarterly percent changes and ROE calculated on actual figures in millions of dollars. ROE annualized and after-tax ROE assumes a 46% corporate tax rate.

Table 21

SECURITIES INDUSTRY CONCENTRATION

Total Revenues	80	81	82	83	84	85	86
Top 10	53.1%	55.6%	57.3%	54.4%	58.8%	57.5%	57.3%
Top 11-25	19.4	18.7	18.7	19.6	17.1	19.7	19.8
Rest of Industry	27.5	25.7	24.0	26.0	24.1	22.8	22.9
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Total Capital							
Top 10	50.8%	50.0%	54.8%	52.8%	57.2%	63.2%	61.9%
Top 11-25	18.0	19.7	18.3	18.8	15.6	14.8	16.0
Rest of Industry	31.2	30.3	26.9	28.4	27.2	22.0	22.1
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Based on capital, the biggest 10 securities firms gave up a little of their predominant share of both industry revenues and capital. Still, with the 10 largest capitalized firms (as of 12/31/86) controlling 57% of industry revenues and 62% of total capital, one would be hard pressed to say that the securities industry is becoming less concentrated. In fact, the 11 through 25 largest firms increased their share of industry revenues and capital a bit. On the revenue side, the rest of the industry made a minimal gain of 0.1% to be left with 22.9% of all revenues. On the capital side, the non-25 largest firms made the same 0.1% comeback to now hold 22.1% of all capital. That's a far shot from the 31.2% share they had back in 1980.

ADDENDUM

In our analysis of the securities industry, SIA relies on the the uniform reporting on the FOCUS form of New York Stock Exchange member firms which do a public business. These firms, though relatively few in number compared to all registered broker-dealers, account for the vast majority of the assets, capital, revenues, profits, etc., of the entire securities industry. It is for this reason, together with SIA's access to the NYSE group's quarterly financials, that this group is used as the proxy for the entire securities industry. Therefore, all references in this report to "total securities industry" refer to these NYSE reporting firms. The following tables give the reader the historical share of the NYSE firms doing a public business vs all broker-dealers listed as registered by the SEC. Data for 1986 for the SEC's "All Firms" is not yet available.

Table 22

NYSE GROUP'S SHARE OF TOTAL INDUSTRY*

Item	(Percent) 1979	1980	1981	1982	1983	1984	1985
Revenues	80	80	81	81	80	81	77
Assets	84	85	78	86	85	88	86
Capital	66	65	66	70	72	71	70
Equity	63	63	65	69	71	69	68
# of Firms							
NYSE Group	374	389	390	387	412	393	381
All Firms	4,824	5,283	5,714	6,165	7,429	8,298	8,763

* Total industry based on data appearing in the SEC Monthly Statistical Review, August 1986.

The first striking fact is that the number of all firms has almost doubled over the above time span while the NYSE group remains about the same. Still, though the NYSE group is now down to about 4% of all firms from 8% in 1979, they still maintain about 80% of all revenues and 85% of assets. It is the NYSE group which handles the "core" amount of securities business and, as was seen just previously in this report under concentration, the vast amount of the NYSE group's business is handled by the 10 or 25 largest firms.

VOLUME

	JAN 1987	JAN 1987	JAN 1986	JAN 1986	% CHAN. J-J 1987-1986
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	193.1	193.1	130.9	130.9	47.5%
AMEX (MILS.)*	14.8	14.8	11.1	11.1	33.3%
NASDAQ (MILS.)*	151.8	151.8	109.7	109.7	38.4%
REGIONAL EXCHANGE (MILS.)*	29.4	29.4	22.3	22.3	31.8%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$163,620	$163,620	$105,010	$105,010	55.8%
AMEX (MILS.)	4,935	4,935	2,746	2,746	79.7%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	11,321	11,321	8,269	8,269	36.9%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	19,103	19,103	18,589	18,589	2.8%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	50.8%	50.8%	49.5%	49.5%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	19,455	19,455	15,226	15,226	27.8%
AMEX OPTIONS	4,789	4,789	4,738	4,738	1.1%
COMMODITY	15,917	15,917	16,279	16,279	-2.2%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

UNDERWRITING

	OCTOBER 1987	OCTOBER 1986	% Change 1987-1986
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$24,211.2	$13,392.5	80.8%
Common Stock	$2,339.2	$645.0	262.7%
# of Common Stock Issues	41	9	355.6%
Preferred Stock	$420.7	$1,901.5	-77.9%
# of Preferred Stock Issues	9	42	-78.6%
Corporate Debt	$21,450.9	$10,846.1	97.8%
# of Corporate Debt Issues	207	114	81.6%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$7,207.3	$1,156.3	523.3%
# of Issues	147	23	539.1%
Competitive	$812.4	$1,196.3	-32.1%
# of Issues	48	55	-12.7%

Source: IDD Information Services

YIELDS

(MONTHLY AVERAGES)

	OCTOBER 1987	OCTOBER 1986	BASIS POINT CHG 1987-1986
BOND BUYER INDEX (20 BOND)	8.61%	8.08%	(147)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	8.36	10.05	(169)
Baa CORPORATE	9.72	11.44	(172)
RATIO Aaa CORPS. TO Baa CORPS.	0.86	0.98	(2)
MUNICIPAL BOND YIELDS (MOODY'S)	6.61	8.08	(147)

PRICES

(END OF MONTH)

	JANUARY 1987	JANUARY 1986	% CHAN. Y-T-D 1987-1986
DOW JONES INDUSTRIALS	2158.04	1570.99	37.37%
STANDARD & POOR'S 500	274.08	211.78	29.42%
NYSE COMPOSITE	156.11	122.13	27.82%
AMEX MARKET VALUE INDEX	300.47	243.87	23.21%
VALUE LINE COMPOSITE	249.17	215.80	15.46%
NASDAQ COMPOSITE	392.06	335.77	16.76%

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
"Opportunities in the 1990's"	Transcript of SIA's eighth annual Trends Conference. Senior industry executives addressed the future of the securities industry with topics ranging from perspectives about overall opportunities available to brokerage firms in the capital and retail markets to specific subjects such as globalization new products in the capital markets area,and firms taking principal positions in their own deals. In addition, market segmentationand asset gathering, and the outlook for traditional and packaged products was discussed.	SIA Research Department Price $75
"Mergers & Acquisitions--Special Report"	Newly compiled rankings of M&A deals effective in 1986 that were valued at more than $1 million. Numbers reveal Goldman, First Boston, and Morgan Stanley snared two-thirds of 1986 M&As. Statistical data includes deals completed and announced by industry and top advisors to these industries.	Investment Dealers' Digest 3/9/87
"The 1987 Pension Olympics"	Annual survey which tallies net new clients that investment management organizations have garnered from over 700 private and public pension funds. The top of the ladder is dominated by bank subsidiaries offering indexing and semi-active products based on computer-driven programs. The winner is Wells Fargo Investment Advisors with a net gain of 18 accounts and an additional $24.7 billion in assets.	Institutional Investor 2/87

Item	Description	Source
"General Eclectic"	A look at the reshaping of the nation's third-largest company, GE. For the past decade, GE's earnings growth has mirrored the growth of GNP. The company wants to do better. Thus, GE's strategy calls for emphasis on fast-growing sectors like high technology and finance. Author presents his own list of potential takeover targets.	Forbes 3/23/87
"Through [illegible] Customers' Eyes"	An interview with SIA Chairman John Bachmann of Edward D. Jones & Co. covering the problems facing the brokerage industry. Issues discussed include the erosion of Glass-Steagall, recent insider trading scandals, and intensifying competition within the industry.	Registered Representative 3/87
"Coping with Globally Integrated Financial Markets"	NY Fed President Corrigan reviews developments in international markets, with emphasis on the areas which give rise to a sense of unease from the central bank's perspective.	Quarterly Review Federal Reserve Bank of New York Winter 1986-87
"Say Goodbye to Your Broker"	Brief update on automating the financial planner. Nevertheless, article concludes that there's still comfort for the customer in having someone who knows his account at the other end of the phone. The "future" could be a long ways off.	Financial World 4/21/87